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The Comparative Economic Performance of Malaysia: An Analysis

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Abstract

A large difference in income today among East Asian countries was brought about mainly by different economic growth rates in the second half of the twentieth century. How do we explain this difference? Neoclassical economists would argue that it was due to difference in the rates of capital formation and export growth. This is true, but the question still remains as to why they differed. This paper, focusing on Malaysia, explains its relative performance in terms of institutions and culture. Due to the growing influence of neo-institutionalists, institutions have been gaining importance, but culture is still an unpopular subject among the social scientists who are looking at the cause of development. But if we ignore it, it is difficult to explain the better economic performance of South Korea vis-à-vis Malaysia (or more generally, Northeast Asian countries vis-à-vis Southeast Asian countries). Of course, culture is not the only explanatory variable. Neo-institutionalists are right in emphasizing the importance of institutions. For example, the better performance of Malaysia vis-à-vis the Philippines and Indonesia seems to be largely due to the fact Malaysia could make its institutions more favorable to economic growth. But we also have to recognize the fact that culture influences people's economic decision, shapes institutions, and mediates their effect on economic growth.

Keywords: culture, institutions, economic growth, Malaysia, East Asia

I Introduction

From Table 1, which shows per capita GNI (Gross National Income) in 2001 in East Asia, we can see a large country difference in income. Why has such difference emerged?

From Table 2, which shows per capita GDP in early postwar years, we can see that income difference was not as large then as in 2001. So, the difference must have greatly magnified in the second half of the twentieth century. Furthermore, some high income countries in the early 1950s, such as the Philippines, became low income countries in 2001, whereas some low income countries in the early 1950s, such as Korea, became high income countries in 2001. This is because, in the second half of the twentieth century, some countries did not have much economic growth, while some others enjoyed high growth. Why did then the countries of East Asia grow at different rates? In answering this question, I want to focus on Malaysia whose growth record was somewhat average.

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Table 1　Per Capita GNI in 2001 in East Asia

Unit: US$

Japan	35,990	Thailand	1,970
Hong Kong	25,920	Philippines	1,050
Brunei	24,620	China	890
Singapore	24,740	Indonesia	680
Taiwan	12,876	Vietnam	410
S. Korea	9,400	Laos	310
Malaysia	3,640	Cambodia	270

Source: [World Bank 2003] for all countries except Taiwan [Republic of China various years].

Table 2　Per Capita GDP in East Asian Countries in Early Postwar Years

Unit: US$

	1952–54	1955–59	1960–64
Japan	224	327	634
Philippines	159	185	158
Thailand	81	85	105
S. Korea	68	73	90
Taiwan	—	146	169
Singapore	—	—	453
Malaysia	251	253	278
Hong Kong	—	—	388
Myanmar	—	65	69
S. Vietnam	—	—	134

Sources: For the sources of the Philippines, Thailand, and South Korea, see Yoshihara [1994: 7; 1999: 281]. For Malaysia, Lim Chong-Yah [1967: 317]. For Singapore, Singapore, Department of Statistics [1967]. For the other countries, ECAFE [various years].

Among the countries for which data are available, Malaysia had the highest income in the early 1950s. I do not have data on Singapore at that time, but it is difficult to believe that Malaysia's income was higher than Singapore's. Nevertheless, the fact remains that Malaysian income was among the highest in East Asia in early postwar years. Northeast Asian countries such as Japan, Taiwan and Korea were not doing too well then. Hong Kong also probably had lower income than Malaysia, because the economy was in disarray due to the Communist take-over of Mainland China a few years earlier.

Today, Malaysia is not among the highest income countries. It has been overtaken by such countries as South Korea. But it has not done as badly as such Southeast Asian countries as the Philippines. The questions to be asked about Malaysia are: 1) why Malaysia has done better than such countries as the Philippines and 2) why it has not done as well as such countries as South Korea.

Neoclassical economists would explain the different growth rates in terms of difference in the rate of capital accumulation or of export growth (capital can include human capital). There is no question that national productivity depends on the amount of capital, so that we cannot argue against the contention that high growth countries had high rates of capital accumulation. Export growth can be also essential for economic growth. Although it is often thought to be important because of its demand effect, more important is its effect on the country's ability to increase imports. The foreign exchange earned by exports can raise productivity by enabling the economy to import the products or services it cannot produce or to import better products at lower prices. High growth countries had good export performance.

If we reason in the way neoclassical economists do, there is no role for institutions and culture. But they pay some attention to institutions, for deregulation, liberalization, and privatization (which create the institutions which give greater economic freedom) are now their mantras for better economic performance. But as will be explained later, institutions are more than that. Culture is, on the other hand, completely ignored. Even the non-neoclassical economists or social scientists who take a broader approach to economic growth tend to play it down, or completely ignore it. I want to explain, first in general terms, that culture is a factor for economic growth, and then how it can be used to explain the comparative performance of the Malaysian economy.

How do I then reconcile the neoclassical contention that growth is driven by the increase of such economic variables as capital and export growth with my contention that institutions and culture are important. I do so, first accepting the neoclassical causation and then arguing that institutions and culture affect the parameters which define the relations among economic variables. I postulate that the way an economic variable is determined by other economic variables differs by country because the parameters defining the relations differ. The parameters are in turn affected by institutions and cultures.

II An Explanatory Framework

Definition

When we say "financial institutions," the term "institution" is used to mean an organization. So, financial institutions refer to such organizations as banks, insurance companies, and securities companies. One trouble with social sciences is that the terms used have more than one meaning. Following the neo-institutional school in economics, I define institutions as rules [North 1990: Chapter 1]. Then, the next question is what is meant by a rule, although the meaning seems to be rather obvious. But it needs to be spelled out since we tend to have different understanding of it. For example, the tax law may say that one has to pay 50 percent income tax if he makes over one million dollars, but it may not be binding on him if he can get away with much less tax by, for example, bribing tax officials. Then, the rule is that the rates of income tax are negotiable despite the fact that they are specified in the tax code. So, an institution is not only about what is written down but also about how it is enforced [*ibid.*: Chapter 7].

There are two kinds of institutions. One is enforced by the government. The institutions of this kind may be called formal institutions. Tax law is one example. Criminal law is another. If one cheats taxes or commits a crime (an act which is punishable under criminal law), he is liable to be punished by the government. The other kind of institutions, which one might call informal institutions, consists of private rules such as customs. These are enforced by society or private organizations. The second kind has influenced the economic performance of East Asia, but probably not as much as the first kind. In the following discussion, for the sake of brevity, I want to focus on the first kind.

Culture, which should be called national culture, is what defines the utility function of the average person of a country through shaping his taste, preference and values. In the following discussion, I rely mostly on this definition of culture and simply refer to it as culture. But it can be defined more broadly. Culture can include the average person's conception of what is right and wrong (or what is just and unjust) and what need to be done when wrong things are done. When the term culture is used in this sense, I want to call it a broadly defined culture.[1)]

Effect of Institutions on Economic Performance

Why are institutions and culture important for economic performance? Institutions affect economic performance through various channels. The following three are the main ones.

1) Institutions define the incentives and penalty for economic activities. For example, an effectively enforced tax law determines how much one can retain his earning and how much he has to pay to the government. If the rate is too high, it is discouraging for private initiative, in particular risk-taking. If a tax law is enforced with a great deal of discretion, there may be incentives for cultivating relations with politicians and bureaucrats. If such activity becomes important for business, national productivity suffers.

2) Institutions determine the degree of economic freedom. How free is it to import goods and services from abroad? How free is it to invest? Does a foreign investor enjoy the same freedom, or if he does not, to what extent is his investment restricted? Is one discriminated on the basis of ethnicity? If so, to what extent? Is it free to start business in any areas? Or if it is not, what areas are not free or to what extent is freedom restricted. Institutions answer these questions.

3) Institutions determine the degree to which property rights are protected. First, property has to be protected from violence and extortion, but how well is it protected from such problems? Second, when the owner of property is challenged by another person as to its ownership, how secure is the ownership and how is the challenge to be settled? Third, when property is rent out, how well are the rights of the owner protected when the tenant does not fulfill contractual obligations or when the lease expires and the tenant does not agree to the rent

1) Those who want to read more about the concepts and explanatory framework presented here, see Yoshihara [2000: Chapter 2].

increase he demands? Fourth, when a person borrows money by mortgaging his property but fails to repay as he promised, how easy or difficult is it for the lender to foreclose the property and sell it to recover the money? Fifth, when he sells goods on credit but he cannot get paid despite the fact that the purchaser has assets, how easy or difficult is it for him to ask the court to foreclose the assets and get paid from the proceeds? There are numerous other problems regarding property rights. Institutions determine the extent to which "property" owners' rights are protected by law.[2)]

The overall effect of institutions on economic performance is often difficult to evaluate, but generally, 1) the greater the incentives for reward for meeting market needs are, 2) the greater the economic freedom is, and 3) the better protected the property rights are, the higher the economic performance is. But what makes overall evaluation difficult is that not all institutions are favorable for economic growth. Even the restriction of economic freedom may have positive effect (or even if the effect is negative, it may not be too negative), if it is implemented in such a way to nurture the industry which has greater growth potential. Therefore, the overall effect of institutions has to be somewhat subjective.

Effect of Culture on Economic Performance

A neoclassical economist might argue that there is no national difference in the utility function of the average person, but if it is so, how does he explain the fact that Malaysia has a low level of pork consumption compared with Germany. If he tries to explain the difference in terms of prices and income, he will make a fool of himself. The reason for a low level of pork consumption in Malaysia is that the Malays who account for about half of the population do not eat pork for the religious reason. In Germany, however, the culture of sausage and ham developed in the past for some reason. The fact that there is no religious constraint on pork consumption in Christianity, the main religion of Germans, may be a reason, but it is not the only reason, for Germans consume more pork than other Christians in Europe. The neoclassical economist then might say that even if so, how does it affect the economic performance of a country? You cannot argue that pork consumption is a factor of economic growth.

The utility function, however, affects other preferences besides pork consumption. Among the various individual decisions it affects, important are 1) savings, 2) learning, 3) work-leisure trade-off, and 4) risk-taking. In general, if culture nudges people into making efforts to improve their material lives, the average utility function tends to favor savings, learning, work and risk-taking. On the other hand, if culture nudges people into accepting the present situation and making the best of it, the average utility function tends to favor today's consumption, leisure and risk-aversion. The former type of culture is more favorable for economic growth than the latter.

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2) The neo-institutionalists' view of institutions, as presented in North, only considers this third effect of institutions.

Interaction between Institutions, Culture and Economic Growth

What I intend to do in this paper is to explain economic growth in terms of institutions and culture. That is, economic growth is the dependent variable, whereas institutions and culture are the independent variables. But there is interaction among the three variables. Institutions are influenced by economic growth and culture, whereas culture is influenced by institutions and economic growth. Why is this so?

Take institutions first. How does economic growth influence institutions? One example is the effectiveness of the police, who are needed to enforce criminal law. It depends partly on income, for, if the police get more budgets thanks to economic growth, they can buy better equipment to catch criminals. Or if they get paid better thanks to more budgets, their morale may improve and thus they may become more effective in catching criminals.

How does culture influence institutions? If I use the broad definition of culture, its influence on institutions is large, but if I define it narrowly, the influence of culture is not much. But there is some. For example, if learning culture is weak, it is difficult to enforce compulsory education (which is an institution) as well as to lengthen its duration. This is what happened in Thailand in its early years of school education. On the other hand, when the nine years of compulsory education was introduced in early postwar Japan, there was practically no problem in its implementation since learning culture was strong.

How is culture influenced by institutions and economic growth? Consider the case of North vs. South Korea. In the mid 1940s when Japanese occupation ended, cultural difference was virtually non-existent, but there is a large difference today. Compared with North Koreans, South Koreans are more responsive to market opportunities or willing to take greater precaution to avoid the punishment by market forces. So, they are more willing to save, learn, work and take risks than North Koreans. This is partly due to difference in institutions between the two countries. North Korea, after Japanese withdrawal, became a planned economy (the economy run by the directions of the planning bureaucracy), and weakened the sense of individual responsibility. On the other hand, South Koreans had to be more responsible for themselves under the market economy.

The present cultural difference between North and South Korea has also something to do with income difference. The income of South Koreans rose faster, which made the level of education rise faster. Education, besides increasing knowledge useful for the economy (thus contributing to human capital formation), changes people's mental horizon. This affects people's preferences and values. When it is combined with increasing income and knowledge, people become more willing to innovate (or take risks). Innovation is somewhat risky, but with increased income, they have a more secure economic base to fall back on when something goes wrong.

Institutional Change and Cultural Difference

Despite such interactions, institutions and culture enjoy a great deal of independence (in the case of institutions, from income and culture and in the case of culture, from income and institutions), and I want to investigate their effect on economic growth.

One might say that economic growth depends on such external factors as world income and prices, and thus not on institutions and culture alone. But how a country responds to such external factors depends on its institutions and culture. For example, an increase of income in major industrial countries is a plus factor for the exports of developing countries, but how much they benefit from it depends on their ability to respond, which depends on their institutions and cultures.

Between institutional and cultural change, the former was a much more important independent variable for economic growth in the second half of the twentieth century in East Asia. True, institutional change depended on economic growth and cultural change, but it was independent to a considerable degree. This is because it depended on factors such as political leadership and foreign influence. On the other hand, cultural change was much more dependent on economic growth and institutional change. Therefore, I take institutional change as the triggering factor for economic growth.

Can we ignore culture then? We cannot. Although cultural change was not that important, culture was. Economic growth began to differ because institutional change differed, but the effect of institutional change on economic growth differed because of difference in culture (*not cultural change*). To put it another way, the cultural difference which existed in the early 1950s weakened or strengthened the effect of institutional change on economic growth. Some cultures were more growth-enhancing than others. In general, the cultures of Northeast Asian countries seem to have been more so than those of Southeast Asian countries.

III Why Has Malaysia Done Better?

The Planned vs. Market Economy

Table 1 shows that the three countries in Indochina (Cambodia, Laos and Vietnam) constitute the lowest income group in East Asia. The incomes of North Korea and Myanmar are not shown (they do not publish national income data), but they are believed to be also very low. Probably they are about the same as Vietnam's or even lower (this conjecture is based on my personal observation of Myanmar and Vietnam and various mass media reports on the three countries).[3] North Korean income may be the lowest since the country has been suffering from famines in the past several years. Anyway, we would be safe in putting North Korea and Myanmar together with Vietnam, Laos, and Cambodia in the bottom rung of the income ladder of East Asia. These economies have either stagnated or if they have grown at all, they have done so much more slowly than Malaysia. As shown in Table 2, Malaysia's income was four times Myanmar's in the second half of the 1950s. We do not know Myanmar's income today for sure, but if it was around Vietnam's in 2001, the difference had grown to 8.9 times. It

3) The Bank of Korea (the central bank of South Korea) estimates the per capita income of North Korea to be around $700, but this is widely regarded to be too high.

would be safe to say that although income difference existed among East Asian countries in the early 1950s, it was about a few times at most. But today, as the example of Myanmar vs. Malaysia shows, the difference has become much bigger. In 2001, Malaysia's income was about 12 times Laos' or Cambodia's.

Why Malaysia has done better than those countries is fairly well understood, so that I shall not dwell on it for long. The major explanation is that those five countries created wrong institutions for economic growth. All of them abolished the market economy and replaced it with the planned economy. Myanmar, Laos, Cambodia and Vietnam abandoned it later on (from the late 1980s to the early 1990s), and shifted back to the market economy, but North Korea still has not. The planned economy and its legacy (the four countries which shifted back to the market economy are still retaining some of the institutions created during the planning period) hindered their economic growth.

What was wrong with the planned economy? Compared with the market economy, the incentives for self-improvement were weak and the punishment for complacency was mild, because people were to follow government directions and not to do more than that. Furthermore, capital (machinery and structure) was not well maintained because the incentives were lacking or weak for doing so. Finally, government leaders could not be held responsible for wrong planning decisions because the political system was totalitarian (people were not allowed to oust bad leaders).

The gap between Malaysia and China may not be greater today than in the early 1950s. But in the second half of the 1970s when Mao's period ended, the gap must have been larger. Since then, China has grown faster than Malaysia, and narrowed the gap somewhat. This is partly because it carried out market-oriented economic reform. It was initiated by Deng Xiaoping who came to power in late 1978. In the 1990s, Deng gradually faded away from the political scene (died in 1997), but his successor (Jiang Zemin) has continued with equal, if not greater, zeal the market-oriented economic reform he initiated. China grew faster than other former planned economies in the region since it carried out reform earlier and with greater determination.

China's faster growth, however, had also something to do with its culture. China has had a more favorable culture for economic growth. I'll not dwell on this here since the cultural factor will be discussed in greater detail in the next section. It would suffice here to say that in the second half of the twentieth century, despite a more favorable culture, China did not do as well as Malaysia because it created wrong institutions under Communism. In the late 1970s, as pointed out above, it began reforming them to promote economic growth, but they were not yet as favorable as Malaysian institutions because China was still stuck with some legacy from the planned economy period (state enterprises, trade and investment control, etc.). Furthermore, the 20 year period since the beginning of reform was too short for culture to make up for wrong institutions.

Malaysia vs. the Philippines and Indonesia

In the early 1950s, Malaysia's income was only 1.58 times the Philippines' as shown in Table 2, but the difference had grown to be 3.5 times in 2001 (Table 1). We do not know the Indonesian level of income in the early 1950s, but the difference with Malaysia's could not have been as large as 5.4 times as in 2001 (Table 1). This is because it is difficult to imagine that Indonesia's income was lower in the early 1950s than that of South Korea which had been devastated by the Korean War a few years earlier. So, since Malaysia's income was 3.7 times South Korea's, the difference between Malaysia's and Indonesia's income must have been smaller than that.

If Malaysia has done better than the Philippines and Indonesia, why? Since these three countries have not adopted the planned economy, their difference in economic growth must be attributed to their difference in market institutions.

Consider Malaysia vs. the Philippines first. One favorable institutional factor for Malaysia is that it did not adopt as restrictive policy as the Philippines. True, Malaysia adopted New Economic Policy in the early 1970s and restricted the economic freedom of the Chinese who had been the main pillar of the economy together with foreign capital. But Philippine institutions had been generally more restrictive on economic freedom, at least until the early 1990s. First of all, the Chinese, most of whom were not Filipinos at the time of independence, were discriminated more severely in the Philippines than in Malaysia. Chinese discrimination eased in the mid 1970s under Marcos' marshal law, but before that, the effect of discrimination was quite severe (the major discriminatory institution was the Retail Nationalization Law passed in 1954). Besides, the Philippines restricted foreign investment and imports to greater extent than Malaysia. Furthermore, the Philippine government created monopolies on commodity trade and intervened in the economy through creating government corporations (especially, banks), setting minimum wages at relatively high level, and controlling the prices of basic commodities and services [Yoshihara 1994: Chapters 3–10].

Government intervention does not necessarily harm the economy, but the way the government intervened has not been favorable for the economy in the Philippines and Malaysia. In South Korea and Japan where the level of government intervention was high at one time, it was reduced over time as the economy developed (though not as fast in South Korea as in Japan). Furthermore, the purpose of intervention in those countries was usually to help the industries with high growth potential become internationally competitive, and the instruments of intervention such as protection from imports were used more or less consistently for that purpose. On the other hand, in Southeast Asia (except Singapore), government intervention had tended to generate a great deal of rent-seeking activities, because there was no pressure (if there was, it was weak) on the businessmen or companies which received government help to meet the objectives set by the government.

The second favorable institutional factor for Malaysia is that it has protected property rights better than the Philippines. Malaysia had the problem of Communist insurgency in the 1950s, but compared with the Philippines, the level of violence was lower. Then, it virtually disappeared, but in the Philippines, it continued to be a serious problem until the early 1990s. Even today, Communist insurgency has not completely died down. The Philippines has suffered in addition from Muslim rebellion, which has made such endeavors as plantation risky as well as scared off foreign tourists. Furthermore, the Philippine crime rate has been higher. What has been damaging to the economy in particular is the off and on kidnapping of businessmen, especially Chinese [*ibid.*: Chapters 12–15].

Insurgency, rebellion and violent crimes are not the only things which threatened property rights in the Philippines. Over time, Philippine institutions became biased against property owners. For example, it became difficult to rent land because tenant's rights were strengthened. Ownership rights (for example, on land) were not well established, so that disputes often arose. Then, the court functioned poorly because judges became increasingly corrupt. In Malaysia, there have been some of those problems, but they were less serious than in the Philippines. For one thing, the court has been by far more effective in adjudicating business disputes.[4)]

Indonesian institutions had up and down. During the Sukarno period, they deteriorated over time as he became increasingly socialistic as well as nationalistic. In 1965, Suharto replaced Sukarno and began reforming institutions. Institutional improvement is the major reason for Indonesia's good growth record in the following three decades. In the mid 1990s, Indonesia temporarily surpassed the Philippines. But compared with Malaysian institutions, the Indonesian institutions during the Suharto period were probably not better. Suharto did not privatize most of the state enterprises he inherited from the Sukarno period. He even expanded some of them or created new ones. Furthermore, the incentives were strong for businessmen to cultivate political connections, because the government had power to influence their fortune and exercised it for corrupt purposes. Then in 1997, when Indonesia was hit by the financial crisis, the economy went into tailspin. The political crisis which ensued weakened the institutions to protect personal safety and property rights and caused capital flight. As a whole, Malaysian institutions were more favorable for economic growth than Indonesian.

IV Why Has Malaysia Done Worse?

Thailand vs. Malaysia

Malaysia was enjoying higher income than Thailand in 2001 (as seen from Table 1), but its growth record had not been as good as the Thai in the preceding half century. In the early 1950s, Malaysia's income was about 3.1 times Thailand's, but in the following years, the difference shrank. In 2001, it was 1.8 times. One reason for the relatively poor performance of Malaysia in the 1950s and the early 1960s must have been decolonization. The British administration which ran the "country" was dismantled, and the Malaysian administration which replaced it was probably not as growth-friendly. The change affected, for example, the

4) More on the Philippines, see Yoshihara [1994].

investment climate for foreign, especially British investors.

The Malaysian administration, however, ran the country better than the Thai even after independence. The period when Communist insurgency was serious was shorter in Malaysia than in Thailand. In the latter, it rose in a crescendo until the late 1970s. In Malaysia, however, it had ceased to be much of a problem by the end of the 1950s. Crimes were also a more serious problem in Thailand where law and order could not be established throughout the country. Gangsters-cum-businessmen (called *chao poh*) controlled certain local areas and ran such businesses as construction and real estate development [Yoshihara 1994: 182–187]. The Thai institutions to protect property rights were not as good as the Malaysian.

Thailand, however, more than compensated for it with greater economic freedom. What handicapped Malaysian economic growth is New Economic Policy (NEP), which started in the early 1970s. Under NEP, the economic freedom of Malaysian Chinese and British investors who had dominated business until then became more restricted in order to create more opportunities for Bumiputras (mostly Malays). If it had reduced the growth potential of the country only temporarily, its negative effect on the economy would not have been too serious, but it turned out to be long-term. This is because it is taking a long time to put Bumiputra businessmen on the same basis as Chinese. In the meantime, NEP has created many rent-seekers (who do not contribute to national productivity increase).[5]

Thailand did not have much trouble with the problem of ethnicity. It could have become a more serious problem in the 1950s and possibly 1960s if Thai nationalists had been given a chance to make it a political issue, but they did not have such a chance since the government was controlled by the military which needed economic growth for its legitimacy. By the time democracy had started in the mid 1970s (but was not firmly established until the early 1990s), most of the young Chinese having been integrated to Thai society, the Chinese had ceased to be a politically explosive issue. So, there was no political need to distinguish Chinese and Thai and restrict the economic freedom of the former to strengthen the economic position of the latter, as happened in Malaysia. Furthermore, Thailand was not very restrictive on other types of economic freedom, such as the freedom for foreign companies to invest. In general, one can say that Thailand's relatively fast economic growth has been due largely to a relatively free business environment.[6]

Malaysia vs. Japan, South Korea, Taiwan, Hong Kong, and Singapore

Japan's income in the early 1950s was lower than Malaysia's, as shown in Table 2. South Korea's income was even lower than Japan's. We have data on Taiwan starting only in the second half of the 1950s. At this time, Taiwan's income was also lower than Malaysia's, though not as low as South Korea's. All these three countries had a higher income than Malaysia in 2001. The data on Hong Kong and Singapore start from the early 1960s. At this time, they

5) For further discussion on the rent seeking activities of Bumiputra entrepreneurs, see Jesudason [1989] and Gomez and Jomo [1997].

6) For further discussion on Thai institutions, see Yoshihara [1999: Chapters 3 and 5].

had higher income than Malaysia, but not 7 times as in 2001; the difference in the early 1950s was probably not more than 1.6 times (the difference in the early 1960s) since it is unlikely that they grew more slowly than Malaysia in the 1950s. So, it would be safe to conclude that all of the five countries grew faster than Malaysia in the second half of the twentieth century.

In the case of Singapore, Hong Kong and Japan, their institutions were more favorable for economic growth than those in Malaysia. In the case of Singapore and Hong Kong, tax rates were lower, there was greater economic freedom, and property rights were better protected than in Malaysia. In the early 1950s Malaysia may have had as favorable institutions as the two, but after independence, its institutions either became less favorable or did not improve as fast as in Singapore and Hong Kong. In the case of Japan, initially its institutions were more restrictive on economic activities, but those restrictions were removed over time, and economic freedom expanded. In terms of economic freedom, however, Japanese institutions may not have been, on average, much better than Malaysian, but they were more favorable for protection of property rights. In particular, they were more discouraging for cheaters, and more effective in settling business disputes.

Taiwan's institutions may have been also more favorable, but it is difficult to say that the same was true for South Korea. South Korean institutions were far more restrictive on economic freedom than Japanese, and the level of government intervention has not declined as fast and still remains relatively high. Government intervention, which restricted the economic freedom of businessmen who were not undertaking the activities the government wanted to promote, may have been a positive factor for growth since it seems to have been effective in nurturing growth sectors such as steel, shipbuilding and semiconductors, but its overall effect does not seem to have been as favorable as the supporters of industrial policy argue. Furthermore, it was a breeding ground of corruption, and in the 1990s when the economy had to move up to high tech industry (which was more difficult to develop under government direction), its negative effect became more noticeable.

On the other hand, South Korea did a better job of protecting property rights. After the Korean War (which effectively ended in mid 1951), there was practically no destruction of property by Communists, nor was there much problem with the extortion of businessmen by Communist insurgents. There were no ethnic conflicts since the country was culturally integrated. Furthermore, the crime rate was low. In fact, it has been lower than in Japan in the past few decades (for example, Koreas has done a much better job of controlling organized crimes). In promoting credit transactions, South Korea developed the system of promissory notes, following Japan. When a businessman sold goods to his customer on credit, he usually received a promissory note. It had to be honored when it was due, since the bank, on which the customer relied for much of his capital, would stop dealing with him if he did not have enough cash in his account to settle it. The businessman who received it could cash it at his bank at discount, instead of waiting until the date was due. Checks were not frequently used, but if bad checks were issued to settle transactions, it was regarded as a criminal act. In Malaysia, the only method of settlement of credit transactions, beside cash payment in the future, was to issue a postdated check, but even if it was not honored on the due date, Malaysian businessmen could get away with much lighter penalty.[7)]

When all things are considered, however, it is difficult to say which institutions (Korean or Malaysian) were more favorable for economic growth. A much faster growth of Korea cannot be attributed to institutions alone.

The Cultural Factor in Malaysia vs. South Korea

As explained in Section II, culture determines the utility function of the average person in a country, which in turn affects the national economy through household supply and demand. The individual utility function determines the marginal rate of substitution not only between goods but also between leisure and work. It also determines the marginal utility of consumption, the trade-off between today's and tomorrow's consumption, and between financial and educational investment. More concretely, it affects working hours (adjusted for intensity), savings, learning, and risk-taking.

South Korea's faster economic growth than Malaysia's seems to have something to do with difference in the average utility function between the two countries. South Korea's utility function seems to have made Koreas more work-oriented, more willing to save and take risks, and more interested in learning.

Unfortunately, I do not have enough data to substantiate it. The few I have are as follows:

1) South Koreans had longer working hours. The average working hours of Malaysians has been a little over 40 hours a week throughout the period, but in Korea it was only in the early 1990s (when the income level was twice Malaysia's) that the working hours came down to the Malaysian level. Around 1970, the average working hours in the non-agriculture sector of South Korea were 56.

2) Many South Koreans went abroad to work (first in South Vietnam and then in the Middle East) [Yoshihara 1999: Chapter 6]. Some Malaysians did, but the number was very small.[8)] Until the mid 1980s when the number of Koreans going abroad dramatically declined due to higher wages at home, about two million Koreans had worked abroad. To work abroad was unpleasant and sometimes dangerous (in South Vietnam in particular), but many Koreans did so for the sake of income.

3) Malaysia began relying on foreign workers at a lower level of income and relied more on them for doing the kind of jobs which does not pay much but requires hard work (such as construction workers). In the late 1980s, when Korean wages became high, the entry of foreign workers into Korea began to be noticeable. The number increased in the following years, but it did not exceed 250,000. In Malaysia, however, a large number of foreign workers

7) In Malaysia, the businessman who issued a dishonored check has to pay only 100 ringgit, but if he has three checks dishonored, his checking account would be closed permanently. This affects his credibility. So, the penalty is not too light (not as light as in Thailand). For further discussion on Korean institutions, see Yoshihara [1999].

8) The Malaysians who went to work abroad were mostly Chinese and Indian.

came in, reaching two million in mid 1997. After this, because the economy was hit by the economic crisis, the number declined, but it is estimated to be still over one million. The Malaysian number is much bigger than the Korean. One explanation for this would be that Malaysians were less willing to work under strenuous conditions than Koreans at a similar level of income.[9]

One might say that it is not true and offer institutional difference as the real explanation. The Malaysians who are looking for a job might say that it is not that they do not want to do the jobs the foreign workers are doing. They say that they are crowded out. This may be true today when jobs have become scarce. They would say further that despite their plight, the employers which could benefit from cheaper foreign workers put pressure on the government to keep the country open for foreign workers. The question is then why the same thing did not happen in South Korea. The cultural factor may be involved in the answer. The Korean employers who needed workers to do unpleasant jobs were probably also interested in bringing in foreign workers, but they may not have had a strong enough incentive because there were enough Koreans willing to work for them at wages not much higher than those paid for menial work. To put it somewhat technically, their opportunity cost of leisure (or not doing extra work) was lower than that of Malaysian workers, which can be explained by difference in the trade-off between work and leisure in the individual utility function.

Another non-cultural explanation might be that foreign workers are needed in a rapidly expanding economy. Singapore, for example, has a much higher percentage of foreign workers, but one usually does not argue that it is because Singaporeans do not have a strong work ethic. Foreign workers are needed to complement the domestic labor force when the economy wants to expand beyond the constraint set by the availability of labor. But still, after the income effect is neutralized, the Singaporeans may have a high opportunity cost of leisure for dirty or physically difficult jobs. Or one can argue that the case of Singapore is different from the Malaysian case, because in the latter, there was a large slack in the domestic labor force, which could have been tightened to meet the demand for unpleasant jobs instead of relying on foreign workers. For examples, peasants who were not working much in the off-season could have been mobilized, but this was not done probably because they had a high opportunity cost of leisure.

4) Table 3 shows the enrolment ratio in secondary schools in South Korea and Malaysia for the period 1970–97. The ratio was higher in South Korea throughout the period.

One might say that it was because South Korea enjoyed higher income than Malaysia in the period since the enrolment ratio is often correlated with income level. But as shown in Table 4, the income of Korea was lower in 1970 and 1980. In fact, it was not until 1982 that South Korea caught up with Malaysia. So, despite a lower level of income, South Korea had a

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9) Among the Malaysians, the preference for leisure and security seems to be stronger for the Malays who account for more than half of the population. On Malay values, see Parkinson [1967] and Tham [1977].

Table 3 The Enrolment Ratio in Secondary Schools: South Korea and Malaysia

Unit: %

	1970	1980	1991	1997
Malaysia	34	48	58	64
South Korea	42	78	88	102

Source: [World Bank relevant years]

Table 4 Per Capita GNP in South Korea and Malaysia

Unit: US$

	1970	1980	1991	1997
Malaysia	356	1,620	2,520	4,680
South Korea	268	1,520	6,330	10,550

Source: [World Bank relevant years]

higher enrolment ratio in 1970 and 1980, and the difference widened in the 1980s and 1990s as the income gap widened.[10)]

Of course, average income was not the only factor determining the enrolment ratio. Government expenditure is another factor, for the larger it is, the lower the parents' financial burden becomes and the more schools there are, the easier it becomes to go to school (one might call this a price effect). But this factor was more favorable for Malaysia since the Malaysian government spent more on education per capita than the Korean. The Malaysian government was spending about 5 percent of GNP around 1980, but the Korean government only 3.7 percent. The percentages varied over time, but they were consistently higher in Malaysia than in Korea.

The other factors were income distribution and urbanization. Urbanization makes it easier for people to go to school (they do not have to travel a long distance). Even if the average income is higher, if income distribution is unequal, the median income is lower than the average income. These two factors were more favorable for South Korea (which had a higher rate of urbanization and more equal income distribution than Malaysia at any given point in time). So, the question is how important they were. We are not sure, but they are unlikely to explain the difference. In 1997, the rate of urbanization in Malaysia was similar to that in Korea in 1980. Income distribution remained more unequal in Malaysia (the Gini coefficient was roughly 0.48 for Malaysia and 0.36 for Korea), but the threshold household income in Korean in 1980 (below which children could not be sent to secondary schools for lack of income) must have been reached by a larger percentage of Malaysian households in 1997 when the average income became three times the Korean in 1980. Yet, the Korean level of enrolment (78 percent) was not reached by Malaysia in 1997 (the enrolment ratio was 64

10) On Korean education, see Yoshihara [1999: Chapter 7].

percent). So, the cultural factor becomes a tempting hypothesis. Koreans probably attached greater importance to education or had greater faith in its value than Malaysians.

The gap in the enrolment ratio in tertiary schools between Korea and Malaysia is much bigger than in secondary schools (Table 5). This also seems to have something to do with culture (as in the enrolment ratio in secondary schools), but it may have been due to difference in government policy. The Malaysian government may have been more restrictive on the establishment or expansion of colleges and universities because there were not enough Malay students who were ready for tertiary education (the government wanted to increase their proportion vis-à-vis Chinese students). The question is then why there was a gap in readiness between the two ethnic groups. One possibility is that the Chinese had higher income than the Malays, but in 1991 when the Malaysian average income became 50 percent more than that in 1980, the Malay average must have exceeded the Chinese in 1980, yet the enrolment ratio in Malaysia was still considerably lower. The cultural hypothesis that the learning culture of Malays was weak compared with the Chinese becomes tempting.

Another possible reason why the Malaysian government restricted tertiary education is that it thought college and university students to be troublesome. If this had been the case, why didn't the Korean government feel the same way? Korean students gave a lot of trouble to political leaders such as Syngman Rhee and Park Chung Hee. One can argue that though they may have thought of limiting tertiary education, the public demand for education was so strong that they could not do so. In Malaysia, if the reason why there were not enough colleges and universities was that political leaders wanted to avoid trouble with students, one can argue that they could do so because the public (especially the Malays who have a large voice in politics) did not have a strong learning culture and so did not strongly object to government restriction. Then, this goes back to the cultural explanation.

I do not want to argue that the difference in enrolment ratios was primarily due to culture. Income, prices, and a number of other things were involved. But culture was possibly one major reason.

Table 5 The Enrolment Ratio in Tertiary Schools: South Korea and Malaysia

Unit: %

	1980	1991	1997
Malaysia	4	7	12
South Korea	15	40	68

Source: [World Bank relevant years]

V The Reasons for Difference in Institutional Change and Culture

Institutional Change

When a country did not do as well as another in economic growth for institutional reasons, either of the following two things must have happened. One is that the first country did not improve institutions as much as the other; the other is that although the first country did not improve institutions much, the other made them worse. The remaining question is why such difference in institutional change (favorable as well as unfavorable for economic growth) arose.

Institutions change for the economic reason, as explained in Section II. For example, police effectiveness improves in high-growth countries because with growing budgets, they buy more equipment and are paid better (so less corruption). Or as income rises, the level of education rises, which makes the public demand better government performance and also makes it easier for the government to recruit better-educated people. Institutional change due to economic growth has to be ruled out, however, because institutions are regarded as an independent variable and economic growth as the dependent variable. We have to look for non-economic factors for institutional change.

The major non-economic factors which come to my mind are as follows. 1) Historical legacy; 2) political leadership; 3) foreign influence; and 4) the natural environment. Let me explain each of these briefly below.[11)]

The period of change examined in this paper is the second half of the twentieth century. Thus, we consider institutional change (favorable as well as unfavorable) starting around 1950. The historical legacy of that time, which includes the institutions and culture inherited from the past, influenced the path of institutional change in the following years. Of course, it was not an active factor. It had to wait for other things to change. Then, it had effect on institutions by interacting with them. For example, a relatively large Chinese minority and Islam were part of Malaysia's inheritance around 1950. Compared with other major religions, Islam turned out to be a tenacious religion, influencing the daily lives of its believers, and separated the Chinese from the Malays. Given such historical legacy and the characteristics of Islam, after independence, as the Malays raised the level of political consciousness (the income factor working through education), they exercised political power as the majority group so as to change economic rules (Bumiputra policy).

The fact that Malaysian institutions did not deteriorate as in the Philippines has also something to do with its historical legacy. Bumiputra policy could have been more extreme, but it was not. Why? The following are possible reasons related to the historical legacy of Malaysia. 1) Being relatively recent migrants, the minorities could not claim the same rights as the Malays. 2) The ruling Malay elite needed the minorities for building a dynamic economy because the Malays did not have much experience with modern business. 3) There was a considerable amount of goodwill for the British among the Malay elite at the time of independence. As a result, they retained many of the institutions the British created as the basis for nation building. 4) Because of historical ties to Singapore and geographical proximity (especially, the second largest city in Malaysia, Johor Bahru, has close economic relations with

11) For further discussion on the general factors for institutional change, see Yoshihara [2000: Chapters 7 and 8].

Singapore), Singapore, which grew rapidly after the separation from Malaysia in 1965, served as a "model" for Malaysia.

Neo-institutionalists have the concept called path dependency for institutional change, which refers to the dependency of future institutional change on the path of the past change [North 1990: Chapter 11]. This comes close to my concept of historical legacy. Through historical process in the past, the present culture and institutions have evolved, and are different from those which have evolved in another country. They will influence the future path of institutional change as the basis of people's interaction with changes in the economy, external relations, etc. Unlike neo-institutionalists, however, I do not think that it is very useful to simply say that institutional change is path-dependent. I argue that we have to specify which part of the historical legacy will have bearing on future institutional change and in what way it will do so. Neo-institutionalists may prefer to make a general theory out of path dependency, but that there is no such theory because path dependency has to be understood in the national context if it has any meaning.

The importance of political leadership in institutional change is more difficult to explain in the case of Malaysia since none have played a dramatic role. Deng Xiaoping in China, Lee Kuan Yew in Singapore and Park Chung Hee in South Korea played a large positive role in their respective countries, whereas Pol Pot in Cambodia, Kim Ilsung in North Korea, and Mao Zedong in China played a large negative role. The effect of political leadership on institutions is clear when the answer is affirmative to the question whether institutions would have evolved differently if a certain leader had not come to the position of power.

In Malaysia, the effect of political leadership was not, however, as non-existent as in Japan. In Malaysia, about three quarters of the post-independence period was run by two men, Abdul Rahman and Mahathir. Rahman probably had moderating influence on Malay nationalism. Mahathir did not reverse the Bumiputra policy he inherited, but seems to have pursued it with caution. Bumiputra policy could have been more extreme under different political leaders.

What makes the factor of political leadership difficult to evaluate is, however, whether a certain leader is leading the country or following it (to be more exact, the wishes of people). The economists would ask whether he is running the country with an independent utility function or he is an agent of people who elected him. In the case of Rahman, one can argue that he was not very pro-Malay because the Malay population was not yet much politically conscious, or in the case of Mahathir, that he was not extreme because the Malay population did not demand it. We are not sure whether Rahman and Mahathir were the agents of people or their leaders, but they were possibly both. They followed the wishes of people but led them to a certain degree.

One example of foreign influence on institutions is capital liberalization before the economic crisis of 1997. Malaysia went along with it because industrial countries and the multilateral organizations (which they supported) pushed it and gave some incentives for it (in the form of concessionary loans and aid). At the same time, there was greater awareness among developing countries that open economic policy would be more conducive to economic growth after a few decades of negative experience with economic nationalism. In short, the ideological environment in the world changed in favor of open economic policy. This, together with the incentives given by the multilateral organizations which supported it, affected the policy of Malaysia. Of course, it was not the only reason, which would be clear in view of the fact that many countries did not accept open economic policy. But the point is that without it, the domestic factors of Malaysia alone would not have been sufficient for the policy which it actually adopted.

Another example of foreign influence on institutions is the American intervention to combat Communism. In Malaysia, its effect is not as clear as in Thailand which bordered Indochina which fell under Communism. If the United States had been inward looking and not intervened in East Asia, more countries would have fallen under Communism, or more trouble would have been encountered in combating it. But because the United States intervened, although it was not successful in such countries as China and Vietnam, it 1) slowed down the spread of Communism in Southeast Asia (for example, tying the Soviet Union and China (the main supporters of Communism in the region) to Vietnam until the early 1970s); 2) assisted its Southeast Asian allies in developing the economy so that people would be not attracted to Communism; and 3) persuaded its allies in the West (including Japan) to assist the Southeast Asian allies in economic development. American intervention seems to have been one reason why Thailand did not fall into Communism. This in turn helped Malaysia by making it more difficult for Communist insurgents to use Thailand as their sanctuary as well as the supply route of the material they needed for fighting.

The natural environment did not change much, so that it could not trigger institutional change. But the fact that it did not change made it difficult sometimes to change institutions. I'll discuss this further after explaining the reasons for cultural difference.

Cultural Difference

If Malaysian culture was less favorable for economic growth than South Korean culture, why? One main reason, after the effect of income and the internal changes it caused (such as education and urbanization) is neutralized, is the natural environment. The hot and humid climate of Malaysia was less favorable for work than the temperate climate of South Korea. The higher morbidity of the Malaysian environment was less conducive to planning over time (the incentives for planning become weak if the chances of living until the end of the planning period are not good). The cold temperature during winter in the South Korean climate was more life threatening than the Malaysian climate which did not have winter, and required planning for survival. It was, however, only after human resources became a more important factor with the replacement of agriculture by manufacturing industry as the mainstay of the economy that the Korean environment became more favorable for economic growth.

The technological change of the past half-century, however, greatly weakened the effect of the environment on culture. For example, progress in medicine reduced the morbidity of the

Malaysian environment; air-conditioners reduced the negative effect of the Malaysian environment on work and study; and progress in agricultural technology raised food production in South Korea and made winter less life threatening than before. But difference remains. For example, air-conditioners are not much of help for outside work. Furthermore, the culture, which was created under the natural environment before the technological progress mentioned above took place, lingered on in the second half of the twentieth century.

The environment is not an entire story for cultural difference. For example, the importance South Koreans attaches to education has something to do with Confucianism. Since the rise of Confucianism in Korean history was not determined by the natural environment, one can regard it as an independent (of the natural environment) factor affecting Korean preference regarding education. But one cannot say that the natural environment did not have anything to do with it. Confucianism, which requires ordinary people to learn a proper way of life through reading, could not take deep roots in the areas where reading was difficult or the incentives for doing so were weak due to the natural environment. To read, one has to exert oneself physically as well as mentally, and know that he is going to benefit from it over time. But the natural environment of Southeast Asia was not very conducive to physical and mental exertion because of high temperature and humidity, and not very conducive to planning because of high morbidity. If one thinks this way, the natural environment was not completely unrelated to the rise of Confucianism in certain countries, though clearly it was not the determining factor.

The Natural Environment and Institutional Change

The natural environment may also influence institutional change through culture. "Culture" in this context is more inclusive than the culture which has been discussed thus far. It includes people's conception of the way how society should be organized (or the sense of justice and injustice) and degree of determination to improve it. Culture, if defined in such a way, can be thought to influence formal as well as informal institutions. The part which influences formal institutions may be called political culture.

The natural environment comes into picture because it may influence the more broadly defined culture and change institutions through it. An environment might be more conducive to the development of a culture to accept things as they are, whereas another environment might be more conducive to a culture to encourage people to change things and persevere if hardships arise in doing so. Institutions tend to improve faster under the second culture than under the first. The natural environment, of course, does not trigger institutional change. Its influence is felt only when it mediates the relations between income and institutional change through culture.

In the case of Malaysia vs. South Korea, although it is difficult to say that Malaysia's institutions were more favorable for economic growth than South Korea's or vice versa, what seems to be true is that South Korean institutions improved more than Malaysian. In the early 1950s, South Korean institutions were less favorable for growth because of inexperience with self-government, wrong leadership (Syngman Rhee), and strong negative reaction to Japanese colonialism. On the other hand, Malaysia had relatively open economic policy at that time. True, Communist insurgency was a problem, but it was contained to certain rural areas, and more manageable compared with the threat South Korean faced. Starting in the early 1960s, however, South Korean institutions began improving rapidly. This was triggered by Pak Chung Hee's accession to power. The fact that it had positive effect on institutional improvement was partly due to his future visions for the country, but it was also related to the political culture of the country. If he exercised power wrongly, he faced strong protest from people, especially students and intellectuals. This had something to do with the level of education of people, but political culture was an important factor.[12)] South Korea could develop such culture possibly because people had greater faith in human progress. This may have been related to the natural environment which was less of a constraint on it than that of Malaysia.

VI Concluding Remarks

Institutions are more accepted by social scientists as an explanatory variable (especially under the influence of the neo-institutional school of economics), but culture is not.[13)] This is partly because they cannot observe culture, but it is also because they do not want to be judgmental about it. But they are often judgmental about the economy and institutions. Why not about culture? If one is willing to accept that there are different cultures, then the next step is to ask how compatible they are with economic growth. Cultures differ as to work-leisure choice, importance attached to education, savings, and risk-taking, all of which are important factors influencing the performance of the overall economy. So, it is logical to argue that some cultures are more compatible with economic growth than others. This does not, of course, imply that the former are more desirable for all purposes than the latter. It is just that the former are more desirable from the growth point of view. This is a judgment from only one dimension of human life. I do not see why we have to avoid that.

What we have to avoid is to attribute anything we cannot explain to culture. We need to explore non-cultural explanations as far as possible. But at the same time, we have to keep in mind that peoples differ as to the desire and the degree of determination to improve their

12) For further discussion on Park Chung Hee, see Yoshihara [1999: Chapter 11].

13) The cultural factor had up and down in the scholarship on economic development in the twentieth century. In the first half of the century, in particular before the Second World War, because of the influence of Weber, cultural explanations were popular. But this changed in the middle of the century and culture ceased to be a relevant factor in the rest of the century. Recently, however, the pendulum seems to have swung back a little. The most significant sign of it would be the symposium on culture held in 1998 under the sponsorship of the Harvard Academy for International and Area Studies (the papers presented there are published in Harrison and Huntington [2000]). The second phase of this study is progressing under Harrison, who is now affiliated with Fletcher School of Law & Diplomacy, Tufts University.

material lives because material conditions have different meaning. This would be clear within a culture, because some people are more interested in material life than others. Otherwise, we cannot explain the behavior of some people who choose to work for others (by entering a religious order, for example). Given this fact, it would be natural to think that different peoples attach different importance to material life. To say that a culture attaches greater importance does not mean that there are no persons who do not. The question is about the importance the average persons attaches. I contend this differs among peoples because there are different cultures.

Culture is more difficult to change if it is related to the natural environment. On the other hand, institutions are considered to be independent of it and therefore easier to change. But they may not be so easy to change, because they may be influenced by the natural environment through the broadly defined culture (including political culture), as explained in the previous section. Economic development (to reach the economic stage where the poverty ratio is low and a majority of people can enjoy a decent living standard) is not as simple as neoclassical economists imply, since necessary institutional and cultural change are not easy to come about. Many development efforts in the past failed because the problem of institutional and cultural change was wished away.

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